Global Rates Weekly

Breaking away

27 October 2017

The View: US and them

With the ECB threading the needle on Thursday, our long EU 5y5y. vs short US 5y5y continues its breakout out of the recent range. We target 140bp

— R. Preusser, S. Rajan

Rates: positioning puzzle

US: Unlike popular belief, we don't believe positioning is at extreme shorts. Some of the recent moves have been driven by expectations of a hawkish Fed chair as opposed to optimism around tax reform

EU: Despite the approaching QE limits, Draghi signaled to markets that both rates and EGB volatility will remain low for longer. Strong economic growth, low volatility and purchases still running at €60bn/m until year-end, endorse long carry trades.

JY: Japanese lifers plan to continue focusing outside of Japan. With higher hedge costs, demand for USTs should be limited and diversification to other markets will continue

AU: Inflation remains subdued and raises the hurdle for Q1 hikes, but keeps the curve steep. We look towards May and November next year for more normal policy settings.

—S. Rajan, C. Zhang, S. Salim, E. Satko, K. Ichiki, S. Ohsaki, S. Yamada, P. Sam, T. Morriss

Front end: the one and only?

UK: We continue to like Dec17-Dec18 OIS flatteners going into next week's expected hike. We see a dovish press conference and vote trumping hawkish QIR forecasts.

— S. Cross, M. Capleton

Volatility: sell low works in vol

Historical analysis of systematic short vol strategies in US rates suggests a predictable ECB, like the Fed in 2014, is supportive of short vol strategies.

— S. Salim, C. Zhang

Supply: fiscal uncertainty to delay coupon increases

US: We expect Treasury to keep coupon sizes steady at the Nov refunding as they wait for greater clarity on fiscal developments. Treasury will likely boost nominal auction sizes starting at the Feb refunding in a gradual manner across the curve.

— M. Cabana

Technicals: US 10y breaks 2.4%, bunds lag, spread widens

US 10y yield finally broke up through 2.40% and we look to this Friday's close to confirm. GER 10y Bund yield failed to close above trend channel resistance.. We think the UST-Bund spread will continue to widen this year.

— P. Ciana

Special Topic: Libor survey key takeaways

80% of our 164 survey respondents believe that LIBOR should continue with a more robust methodology, and 73% believe LIBOR should continue alongside a risk-free reference rate alternative.

— R. Axel, M. Cabana, S. Cross

Rates Research

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Our medium-term views

	Rationale
Duration	• US: With the market now pricing 80% chance of a December hike; we turn neutral the front end of the curve. We remain short the 5y-10y point on the belief that tax reform chances are higher than priced in and will push term premium 40-60bp higher if passed. • EU: We expect EUR duration to move more in line with the (improving) economic data and the effective reduction in the amount of duration the ECB absorbs in Bunds through QE. Still, in swaps, we continue to see potential for EUR rates to outperform US, especially in 5y5y forward • UK: structurally bearish Gilts on stretched cross-market valuations and need for a political risk premium. Favorable near-term supply/demand dynamics tempers this bias.
Front end	• US: The Fed set a low hurdle for a December hike and a high hurdle for stopping the balance sheet unwind, which should result in tighter funding conditions & greater repo specials over time. Bill supply will be subdued (+$100bn) in the near term due to the debt limit but should increase heading into year end. • UK: We like front end flatteners as we don't see the BoE hiking as much as market pricing. We also like being short 3y Gilts vs. OIS on Brexit risks. • EU: We are neutral as the market has now pushed the pricing of 1st 10bp ECB Depo hike to Q2 2019, consistent with an end of QE in Dec18 and a 6m period between the end of purchases and the first hike. Fwd guidance may be strengthened further down the road, but markets may not price this over coming weeks • AU: We anticipate for the case to build for an eventual modest normalization of RBA policy, but not until next year. The AUD OIS curve is relatively flat and we like 5m vs 12m OIS steepener.
Curve	• US: We maintain the view that the curve should steepen from here as terminal rate and term premium pessimism fades. We believe easier fiscal policy, higher deficits and higher inflation expectations is likely to steepen intermediate curves (2s-5s, 3s-7s) • EU: in swaps, corporate issuance in 10s and potential ESM paying can continue to push the curve steeper. We hold a 3m 10s30s conditional bear steepener. In cash, much will depend on the maturity of ECB purchases going forward vs maturity of treasury issuance. We believe any significant long-end steepening in core and peripheral curves will ultimately see both debt agencies cut down on the maturity of their issuance and the ECB QE move further out the curve. • JP: We see the JP curve steepening through 2017 as the BoJ steps back from intervening in quantities • AU: We expect the 5s-10s curve to steepen, driven by the attractive mid-curve carry opportunities while higher inflation and supply weigh on the long-end. • UK: Gilt flows suggest continued demand for ultra-long end cash. We like being long UKT 2068s versus 10y20y swaps.
Inflation	• US: We turn bullish on breakevens as the USD impact should start to pass through while consensus remains overly bearish. • EU: Underlying "lowflation" forces are being masked by base effects lifting inflation temporarily. We would be short 10y10y EZ inflation versus US. • UK: We like 10s50s real curve flatteners. Forecast slide in inflation makes front-end expensive and November index events should prompt rebalancing longer.
Spreads	• US: 30y spreads biased wider but risk of increased deficits adds a tightening threat, mostly in the 7y sector. GSE reform risks have increased. • EU: While we see clear supply risks for the periphery early next year, the ECB's strive for predictability and the fact it maintained an open ended QE favor carry trades in the near term. This could lead 10y BTP-Bund spreads to break the 140bp levels. We still like 5y swap spread wideners as a tail risk hedge. • AU: RBA risks have changed. We now see cross market spread compression looking more mature.
Vol	• US: Our analysis suggests that 2s-5s now has room to bull steepen if rates were to decline from here. We recommend conditional bull steepeners to hedge against risk events that could lower near term hike probabilities. Further out the curve, we think payer skew is cheap. • EU: The ECB's decision points to low rates for longer and low volatility, ie a continuation of the Mar16-Oct17 environment. Vs rates, vol remains cheapest in intermediate expiries on 10y and 30y tails, and are least cheap the top left (likes of 1y1y, 1y2y). We still hold a 2y5y payer ladder.

Our key forecasts

(% EOP)	2015	2016	2017	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18
Fed Funds	0.25-0.50	0.5-0.75	1.5-1.75	1-1.25	1-1.25	1.25-1.5	1.5-1.75	1.75-2	2-2.25
10-year treasuries	2.27	2.44	2.85	2.30	2.33	2.85	2.85	2.85	2.85
ECB refi rate	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10y Bunds	0.63	0.21	0.60	0.47	0.46	0.55	0.60	0.65	0.70
BOJ	0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
10y JGBs	0.26	0.05	0.08	0.09	0.07	0.07	0.08	0.08	0.10
BoE base rate	0.50	0.25	0.50	0.25	0.50	0.50	0.50	0.50	0.50
10y Gilts	1.96	1.24	1.60	1.26	1.37	1.50	1.60	1.80	2.00
RBA cash rate	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75
10y ACGB	2.88	2.77	3.10	2.66	2.84	3.05	3.10	3.20	3.25

Source: BofA Merrill Lynch Global Research

What we like right now

AMRS	We like 2s-5s curve steepeners, short US 5y5y vs EU, wider 30y spreads and 5y breakeven longs.
EMEA	In EUR, the ECB's decision gives another green light to carry trades. in the UK, we hold a Dec17-Dec18 OIS curve flattener.
APAC	We like steepeners in Japan and Australia.

For a complete list of our open and closed trade ideas, please refer to Rates Alpha trade recommendations.

The View

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The week that will be

With the ECB threading the needle on Thursday, our long EU 5y5y. vs short US 5y5y continues its breakout out of the recent range (current level of 115bp). As the ECB has effectively prevented the timing of the first hike advancing much from Q2 2019, any fear of a Bund tantrum should subside in the near term. At the same time, the near term optimism around the budget process and better than expected data should continue to help the short US leg of the trade. We continue to target 140bp on the cross market spread.

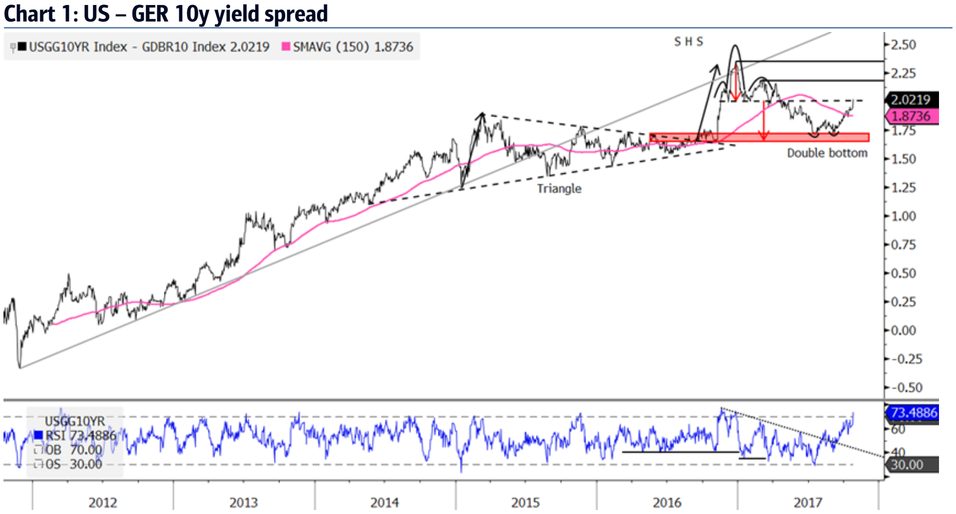
Next week, the focus shifts to US data (ISM and payrolls) and the Fed chair announcement. At this point, we believe a Taylor chair scenario would reprice the market by another 10bp, while a Powell Chair/Taylor vice-chair combination will lead to a small sell-off (<5bp) led by the belly of the curve. Also in focus will be the Ways and Means committee's plans to release the tax bills on Nov 1st. Note that given the binding constraints for the tax bill are largely in the Senate (both because of the vote count room and the Byrd rule), we don't expect the House bill to have all the answers.

Elsewhere, the BoEs communication around the expected hike, will be key – in our view, the split vote will convey dovishness but the inability to really convey a "one and done" until data turns may prove a bearish risk for Gilt yields in the near term as they approach YTD highs.

The week that was

We continue to believe the synchronization of global growth that we highlighted earlier this month (Liquid Insight: Symptoms of synchrony 10 October 2017) remains a key driver of the global sell-off in bond yields that we are seeing. Our bias remains that rates continue to re-price higher – led by the US over the next two weeks. From there on, the headline risks around the details of the tax reform and negotiations around the government shutdown and DACA program will likely provide a breather.

Chart 1: US – GER 10y yield spread



Source: BofA Merrill Lynch Global Research, Bloomberg

Rates – US

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Positioning puzzle

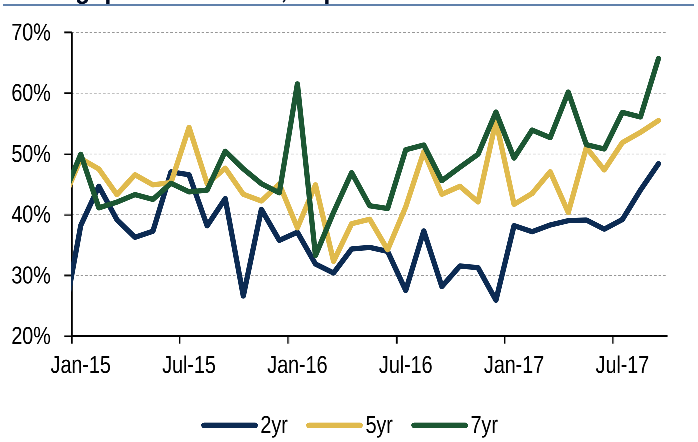
- Unlike popular belief, we don't believe positioning is at extreme shorts or serves as an impediment to a further market sell-off.
- Some of the recent moves have been driven by expectations of a hawkish Fed chair as evidenced in the proportion explained by Fed expectations vs. term premium. We maintain our 2s-5s steepening view.

Positioning is not that short

While much of the focus in terms of positioning has been on the extreme shorts by speculators in the futures market, three reasons lead us to believe that short positioning is not as stretched as widely believed.

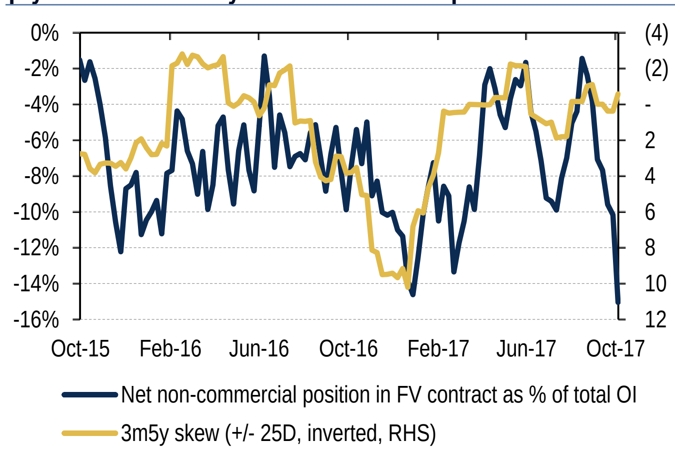
- **Asset managers bought the September dip:** As we highlighted in our flow report recently, total return funds had outperformed the AGG index in September as Treasuries sold off, indicating a short duration bias. This was likely largely covered in the 2.25-2.30 range given that the same group has underperformed month to date. The average return from the top 10 total return funds we aggregate is -0.38% vs -0.22% for the AGG in October so far. Note that corporate spreads have tightened and MBS spreads have largely been unchanged.
- **Particularly in the auctions:** While Treasury auctions recently have been weak, a closer look at the allotment data suggests that investment funds have used the weakness to buy the belly of the curve in the end of September. As Chart 2 shows, September allotment stats saw a marked pick up in investment fund allocations relative to prior months and about 20 percentage point increase compared to a year ago in 5y and 7yr auctions.

Chart 2: investment funds auction allotment takedowns have been trending up in recent months, despite weak auction stats



Source: BofA Merrill Lynch Global Research, US Treasury

Chart 3: While speculator positioning has turned to extreme shorts, payer skews have barely moved over the same period



Source: BofA Merrill Lynch Global Research

- **No demand for skew:** Finally, payer skews have not moved noticeably in this sell-off, indicating little change in positioning. Interestingly, as Chart 3 shows, payer skews on 5y tails are correlated to speculative positioning. As speculators become short, there is also demand for high strike payers. However, this time around, the skews have barely budged indicating little change in broader positioning.

The above three factors leave us skeptical on the recent take in positioning – in our view, shorts are not as crowded as CFTC data suggest and are not an impediment for a further market move.

Breaking bonds

That said, the announcement of the Fed chair matters in the short-run and has the potential to reverse some of the moves. With the nearly 40bp sell-off from the lows in yield, Table 1 tabulates the current move vs. previous sell-off episodes seen since the taper tantrum. Two things stand out

- The proportion of the front end move (FF1 vs. FF9) relative to the 10y move is higher than all prior episodes since the US taper tantrum.

- On the other hand, the proportion of the move explained by a rise in term premium (per ACM) is lower than prior episodes.

This adds evidence that some of the recent move has been driven more by speculation of a more hawkish Fed chair as opposed to optimism around tax reform.

Table 1: The recent sell-off have seen much more repricing in Fed expectations and much less change in term premium

		Market moves			Move relative to 10y			
Start	End	10y UST(bp)	FF1-FF9 (bp)	10y term premium (ACM, bp	FF1-FF9	Term premium	# trading days	Trigger
2-May-13	5-Sep-13	137	12	132	8%	97%	90	Taper tantrum
4-Nov-16	16-Dec-16	82	17	60	21%	74%	30	Trump election
17-Apr-15	10-Jun-15	62	15	63	24%	102%	38	Bund sell-off continuation
30-Jan-15	6-Mar-15	60	24	44	40%	73%	25	Bund tantrum
29-Oct-13	31-Dec-13	52	1	50	2%	94%	45	QE taper pricing
8-Jul-16	4-Nov-16	42	20	43	47%	102%	85	Post Brexit + BoJ
8-Sep-17	25-Oct-17	38	29	17	77%	45%	33	Global growth + hawkish CBs + tax reform
14-Oct-15	9-Nov-15	37	27	11	71%	29%	18	1st Fed hike pricing
24-Feb-17	13-Mar-17	31	8	9	25%	30%	11	March hike pricing
24-Aug-15	16-Sep-15	29	12	24	42%	82%	17	Post China deval
26-Jun-17	7-Jul-17	25	-5	27	-20%	108%	9	Hawkish CBs post Sintra
18-Apr-17	10-May-17	25	16	16	64%	67%	16	ACA repeal vote

Note that FF1-FF9 is used only as an indication of Fed expectations and is not necessarily consistent with the expectations used in the ACM model. Hence the proportion explained by the two does not sum up to 100.
Source: BofA Merrill Lynch Global Research, Bloomberg

In our view, some of this could reverse under a scenario where John Taylor is not appointed (either to Chair or Vice Chair), leading to a bull steepening in the curve. However, even this should see the rally led by 2018 forwards, leading to a bull steepening of the curve. Table 2 simulates the fair value for rates under different hiking outcomes. Clearly, the dovish scenarios over the next two years see a bull steepening of the 2s-5s curve.

Table 2: Fair value changes under various hiking scenarios (assuming a Dec '17 hike)

	Number of hikes over the next five years to reach terminal Fed funds rate of 2.5%									
2022	1									
2021	1	1				1				
2020	1	1	2	1		1	1		1	
2019	1	2	2	3	4	1	2	3	1	2
2018	1	1	1	1	1	2	2	2	3	3
Changes from current markets (as of 10/26)										
2s	-3	-3	-3	1	10	10	10	13	24	24
3s	-1	8	8	15	23	16	22	25	31	32
5s	5	14	14	20	24	19	24	26	29	30
2s5s	8	17	17	19	15	9	14	13	5	6

Source: BofA Merrill Lynch Global Research

Rates – EU

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- The ECB's decision reinforces the idea that rates and vol will remain low for longer, supporting short term carry trades, especially as positioning in periphery was short.

QE is halved, Long live QE… and carry trades

The ECB delivered the quantum of QE that consensus expected: a 9m extensions from Jan18, at €30bn/m. Yet Bunds rallied a substantial 7bp on the day and peripheral spreads tightened. The two aren't inconsistent. In fact market reaction appears justified given:

- The open-ended nature of QE was maintained, with a commitment from the ECB to upgrade and/or extend further if needed. Even if no indication was given as to how the current QE flexibility would be used to make this claim credible, at the margin, it would have surprised those who were looking for a fixed end date.
- The idea of low rates for longer was made by the combination of three decisions:

  1. The open-ended nature of this QE extension, coupled with a reiteration of the current sequencing and forward guidance on rates

  2. The commitment to reinvest QE redemptions for an extended period of time after the end of net asset purchases, and in any case for as long as necessary

  3. The extension of the fixed rate / full allotment procedure for MROs and 3M LTROs until at least end of 2019. This, together with (2), makes the case for a substantial level of excess liquidity in the system for at least the next 2 years. Eonia should thus remain anchored around the Depo rate over that period.

- Positioning in Bunds and the periphery was short (see results of our October FX and Rates Sentiment Survey), with market participants likely assigning some probability to a more hawkish overall QE quantum in 2018 (€20bn/m for ex). Note that compared to last Thursday, 10y Bund yields are still up 2bp, despite substantial coupons and redemptions being paid this week, and large index extensions to be expected at month-end (see last week's EU rates section).
- Last but not least, the mere fact that the ECB delivered a QE quantum exactly in line with consensus, and did not make any technical or other policy change means it reinforced its predictable nature. This reminds us of the US throughout 2014, a period where the Fed delivered steady reductions in QE and maintained a clear forward guidance. The result was that the market priced a linearly declining number of months to the first rate hike, and systematic short vol strategies performed well across all tails (see volatility section).

Going forward, our base case scenario remains for a grind higher in Bund yields as riskier assets benefit from: (1) an expected low volatility, (2) an ECB policy perceived as accommodative (with purchases also more skewed toward risky assets, namely private sector bonds), and (3) the continuation of solid economic growth globally. We think in particular that peripheral spreads have the potential to settle in a lower (more bullish) trading range. The real test will be Q1 next year, when large government bond supply hits the market while ECB flows adjust lower, but as mentioned in our previous reports, it may be too early at this stage for the market to trade these 2018 supply risks.

In addition, the tapering sweetener we were expecting, namely a hint to a lengthening of the weighted average maturity (WAM) of QE net purchases/reinvestments is a bullet the ECB still has in its pocket, which could be particularly supportive for the periphery. Also, the data on November QE purchases (to be released early Dec) could show the start of substitute purchases in Germany, providing another boost to risky assets.

Periphery: tightening blindly ahead of a supply shock

Last month, when BTP-Bund was trading above 170bp, we argued that BTPs were already discounting a consensus ECB QE taper (which at the time was equivalent to little above 30bn/month net purchases + QE re-investments) and that it was unlikely the October tapering announcement would cheapen BTPs meaningfully. We also argued that the worries that some investors were having on the Italian elections were overdone – whoever "wins" government would not be able to push significant reforms through: the proportional nature of the electoral law cuts both the upside (structural reforms) as well as the potential downside stemming from populist proposals.

The good: higher demand (but conditional on low volatility persisting)

One month later the market largely surpassed our benign view on the bullish side. Indeed, the reasoning seems simple: banks are at a better position (i.e. Intesa 5y CDS trades close to the 2014-2015 lows and NPLs are lower than in 2016), economic growth is largely on track with the 2005-2006 pace and, for now, the market become more comfortable with elections risks.

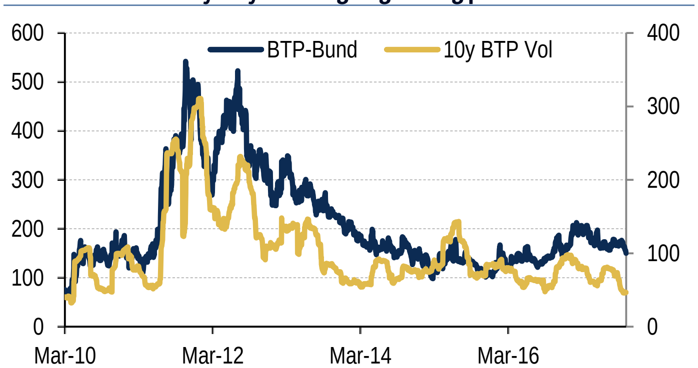
That said, the pick in BTPs relative to Bunds is still high, at c.150bp, similar to Dec16 levels. What's more, the realized vol of 10y BTPs has not been this low since May 2010.

If volatility manages to remain subdued (as it should bar the resurgence of geopolitical risks and any surprise out of the Sicilian regional election on Nov 5th), we think the next point to watch for BTP-Bund will be the 2016 trading range of 120-140bp. In fact, the speed of the recent spread tightening has taken many by surprise. The overseas accounts, in particular, who cut peripheral exposure back in 2016, could capitulate and join the carry bandwagon (the share of non-resident holders of BTPs is now 35%, down significantly from the 50% in 2008's). Also, with the Catalonia-Spain confrontation set to continue for longer, the sweet-spot for carry trades (once adjusting for volatility) is now Italy, not Spain nor Portugal (Table 3).

The bad: BTP DV01 supply reaching the private market set to rise in Q1

As mentioned above, the market will find out in January whether indeed it is right in assuming that ECB QE tapering is a non-event. In fact, all else equal, the increase in BTP 10y equivalent supply that would need to be absorbed by the market rises to the highest since at least 2010. Given the overlap between high seasonal issuance in Jan-Feb and the electoral campaign, the resulting rise in volatility may wash many of the long carry positions out. We think, it is mainly down to national treasuries to normalize the WAM of issuance to the pre-QE levels in order to avoid a sharp re-pricing of spreads.

Chart 4: Low volatility may exert high tightening pressure in BTP-Bund



Source: BofA Merrill Lynch Global Research. We show the difference between 10y BTP and Bund (lhs) vs the annualized 3m rolling volatility of yield changes (rhs). All values expressed in basis points.

Table 3: BTPs may be the next spot for long carry trade re-allocations

	2y	3y	5y	7y	10y	15y	30y
DE	0.17	0.34	0.41	0.31	0.36	0.25	0.09
NL	-0.17	0.31	0.47	0.49	0.34	0.21	0.10
AT	0.12	0.25	0.47	0.47	0.37	0.23	0.13
FI	0.11	0.40	0.48	0.47	0.34	0.24	0.13
FR	0.54	0.47	0.47	0.50	0.37	0.29	0.16
BE	0.14	0.31	0.48	0.51	0.39	0.28	0.16
IE	-0.07	0.23	0.54	0.56	0.39	0.32	
ES	0.38	0.64	0.56	0.58	0.41	0.27	0.16
IT	0.56	0.82	0.82	0.72	0.52	0.31	0.22
PT	0.43	0.64	0.54	0.56	0.37	0.35	

Source: BofA Merrill Lynch Global Research. We show the country's bond benchmark 3m Carry & Roll standardized by the quarterly volatility of yields

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Hedged UST not cheap… where would lifers invest?

Pace has slowed, but preference for foreign bonds continues

This week, the 1H FY17(Apr-Sept) fund management results and 2H FY17(Oct-Mar18) management plans of Japan's major life insurers came out. Amid the ongoing low-yield environment, insurers apparently preferred foreign bonds over domestic bonds (Table 4). In 1H FY17, nearly all life insurers maintained or reduced holdings of domestics bonds while increasing holdings of foreign bonds. However, the amount of overall investment in foreign bonds appears to be much smaller than last year. MoF's data on international transactions in securities show that life insurers purchased a net ¥1.7trn of foreign bonds in 1H of this fiscal year (April-Sept), which marks a big reduction from ¥6.9trn in 1H FY16 (Chart 5). The main factors behind the purchasing decline are probably that sales suspensions and higher prices for savings-type products have reduced the growth of funds under management, and hedge costs have kept rising. We believe that foreign bond investment by Japanese investors peaked out last year, and we maintain our view that life insurers will increase their holdings of foreign bonds by about ¥2-3trn in FY17.

Table 4: 2H FY17 fund management plans of major life insurers

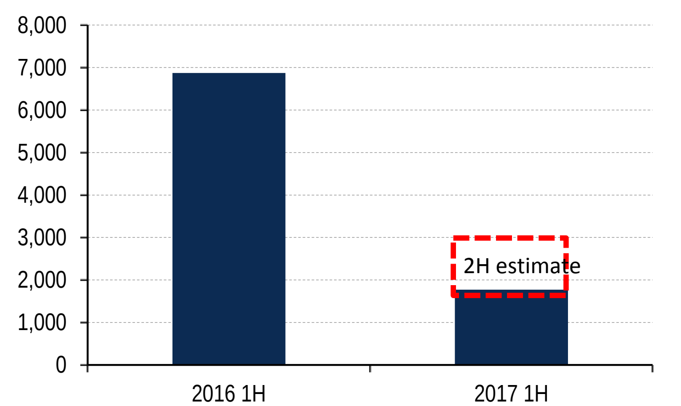
		Domestic	Foreign Bonds		Domestic	Foreign
		Bonds and Notes	Hedge	Nonhedge	Equity securities	Equity securities
Nippon Life	**FY17 2H**	⇨	⇩	⇧	⇨	⇧
	FY17 1H (A)	▲40bn ⇩	510bn ⇧	230bn ⇧	80bn ⇧	90bn ⇧
Dai-ichi Mutual Life	**FY17 2H**	⇩	⇨ (depending on interest rate)	⇨ (depending on FX rates)	depending on stock price	⇧
	FY17 1H (A)	⇩	depending on interest rate	depending on FX rates	depending on stock price	⇧
Meiji Yasuda Life	**FY17 2H**	⇨	⇧ (depending on interest rate)	⇧ (depending on FX rates)	⇨	⇨
	FY17	⇩	depending on interest rate	⇧	⇨	N A
Sumitomo Life	**FY17 2H**	⇨	⇧	depending on FX rates	⇨	⇨
	FY17 1H (A)	⇨ (FY17 Plan)	mainly with hedge 640bn ⇧		▲20bn ⇩	50bn ⇧
Mitsui Life	**FY17 2H**	(▲1-20bn) ⇩	⇨	200-300bn ⇧	⇨	NA
	FY17	(▲2-30bn) ⇩	(1H Actual) ⇨	70bn (1H Actual) ⇧	⇨	N A
Taiyo Life	**FY17 2H**	⇨	⇧		⇨	NA
	FY17 1H (A)	⇨	increased the weight of nonhedge ⇧		⇧	N A
Daido Life	**FY17 2H**	⇨	⇧		mainly with domestic sstocks over 40bn ⇧	
	FY17 1H (A)	25bn ⇧	80bn ⇧		5bn ⇧	35bn ⇧
Aasahi Life	**FY17 2H**	Progress on schedule	mainly with hedge 50bn ⇧		Progress on schedule	NA
	FY17	▲90bn ⇩	mainly with hedge100bn(1H Actual) ⇧		10bn ⇧	N A
Fukoku Life	**FY17 2H**	▲30bn(FY17) ⇩	mainly with nonhedge20bn ⇧		▲10bn ⇩	40bn(FY17) ⇧
	FY17	▲40bn ⇩	▲70bn(1H Actual) ⇩	130bn(1H Actual) ⇧	10bn(1H Actual) ⇧	30bn ⇧

Source: Bloomberg, Reuters
FY17 2H (Plan), FY17 (Plan), FY17 1H (Actual), ▲ represents decrease , (⇨) unchanged, (⇧) increase, (⇩) decrease,

Hedge cost seems to be more expensive than FX risk

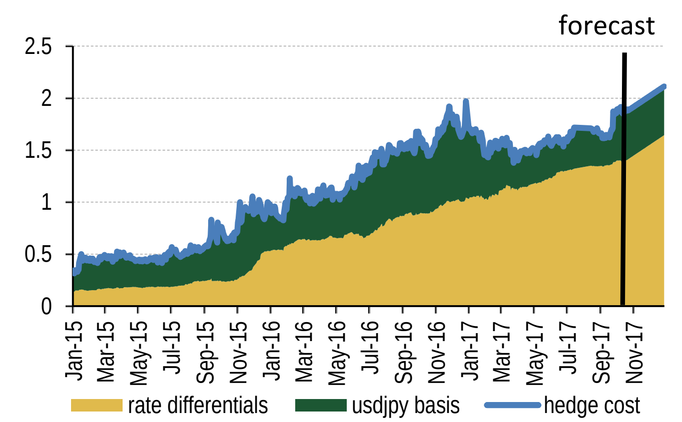
Regarding foreign bonds, although the pace of investment has declined from last year, the plan to increase overall holdings has not changed from 1H. However, diversification by region appears set to advance another step. Two factors reducing demand for US bonds are higher hedge costs in line with the rise of US yields and the flattening of the US yield curve. Rate hikes are expected to continue in the United States, while none are expected for the time being in Japan, so we believe USD hedge costs will rise further. We do not expect the USD/JPY basis spread to widen as much as it did last year, but calculations based on our interest rate forecast suggest that the cost of a USD hedge (3-month rolling) will exceed 2% at the end of this year (Chart 6). For this reason, demand for US Treasuries cannot be expected to increase unless long-term yields rise to level that offsets hedge costs. Diversification into higher-yield products such as corporate bonds is likely to proceed. In light of 1H fund management results, many life insurers are increasing investment without hedges. Although it is largely dependent on levels of FX and rates, unhedged foreign bond investment will probably increase, as indicated in fund management plans. Regarding domestic bond investment, JGB yields are expected to stay low, so investment in JGBs will probably be held to a minimum and insurers remain focused on credit products. We believe the BoJ's next step will lead to steepening of the yield curve, and if it does, life insurers' strong latent demand for JGBs can be expected to emerge, but in the short term that is improbable.

Chart 5: Life insurers' 1H foreign bond investment comparison (¥bn, net purchase)



Source: BofA Merrill Lynch Global Research, MoF

Chart 6: USD hedge cost and its breakdown (%, 3m rolling)



Source: BofA Merrill Lynch Global Research

Reducing USD/JPY downside risk

Lifers may buy USD in rising-yield or strong-yen phases

As explained above, higher hedge costs could potentially make unhedged foreign bonds more attractive than hedged foreign bonds. Most of them forecasts the USD/JPY to range 100-120, and lifers may buy USD on dips or if US yields rise. We believe the scale of such purchases could be up to ¥1trn for the rest of this fiscal year. These potential demands could tighten the USD/JPY supply-demand balance. Meanwhile, non-yen insurance plans may continue to generate AUD demands. The EUR/JPY spot rate is not far from the ¥140 level that most insurers place at the top of their forecast range, and in light of the low hedge cost, EUR demand might be limited.

Widening pressure on JPY basis may be marginal

As seen above, not only will total foreign bond purchases probably decline, but insurers are expected to increase unhedged relative to hedged foreign bond investment. Various factors could affect basis spreads, and as we have pointed out before, some of those factors are structural, so the basis spread expansion effect from foreign bond investment by life insurers will probably be marginal unlike in FY16.

Rates – AU

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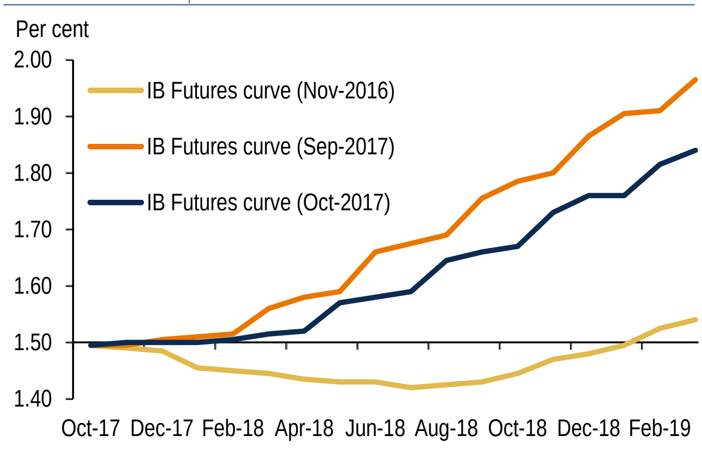
- Inflation remains subdued and raises the hurdle for any Q1 hikes. We look towards May and November next year for more normal policy settings.
- The gradual approach to policy by the RBA argues for a steeper yield curve as global rates move higher. We hold a curve steepening position but close our 5y BEI.

A later commencement from the RBA

We expect the Reserve Bank of Australia (RBA) to be slower and more gradual than other central banks to unwind extraordinary policy, which argues for the curve to remain steep and limits some AU US 10yr spread widening scope in the near term. We now expect a later start than we previously thought following muted inflationary pressures in the September quarter, despite partly being skewed by temporary falls in food prices. The annual underlying inflation rate is in the lower band of the RBA forecast range so there is even less scope for any upward revision to growth forecasts in the upcoming Statement on Monetary Policy on 10th November. We now expect a 25bp hike in May rather than February next year, followed by another move higher in November.

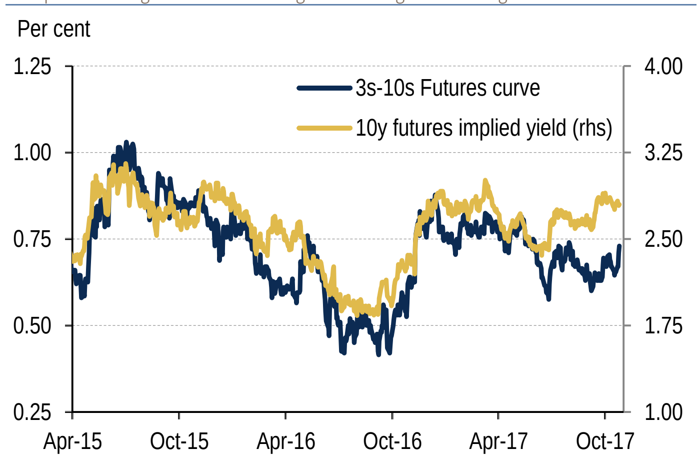
The upbeat view on the broader economy by the Bank and the overall core momentum still supports more normal policy settings over time. The IB futures curve has flattened in line with the patient stance by the RBA (Chart 7), which also improves prospects of front-end carry trades relative to other core markets in the near term. The large October index-extension is likely to underpin support for duration in coming days, but we would expect the curve to be even steeper once month-end is out of the way and with the global backdrop of higher yields weighing on the long-end (Chart 8).

Chart 7: Repricing of RBA expectations following CPI outcomes
The first hike has been pushed out to the end of 2018



Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 8: The curve should be more directional with the longer-end
Steeper curve as global rates move higher and weigh on the longer-end



Source: BofA Merrill Lynch Global Research, Bloomberg

Our preferred expression to benefit from steeper AU curves is via a QTC June-2021 vs. ACGB Nov-2027 mid-curve position. In our view, we see the most upside to activity in Queensland (QLD), which appears well placed for outperformance relative to other states. The trade gains from any underperformance of AU government rates driven by risks surrounding the ACGB longer-end. The position is currently at 48bps, targets 60bps and carries positively at net +2.5bp per quarter. Risk in the near term is from the upcoming duration extension.

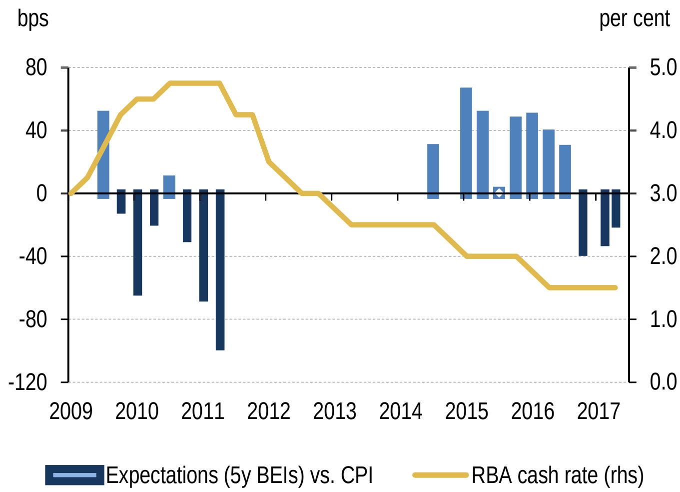
Close our inflation breakeven position

We take this opportunity to close our long ACGB 5y breakeven position following the more modest inflation outcomes in the September quarter. While we still anticipate for headline inflation to continue rising in coming quarters, we prefer expressions which benefit from curve steepening as the Bank stresses patience. Current valuations around inflation expectations remain disconnected and appear more consistent with tightening cycles (Chart 9).

Furthermore, the improved carry prospects towards the front-end could limit real yield (vs. nominal) outperformance (Chart 10). Such positioning moves have previously weighed on inflation breakevens, we close the trade at 1.68% after entering at 1.71%.

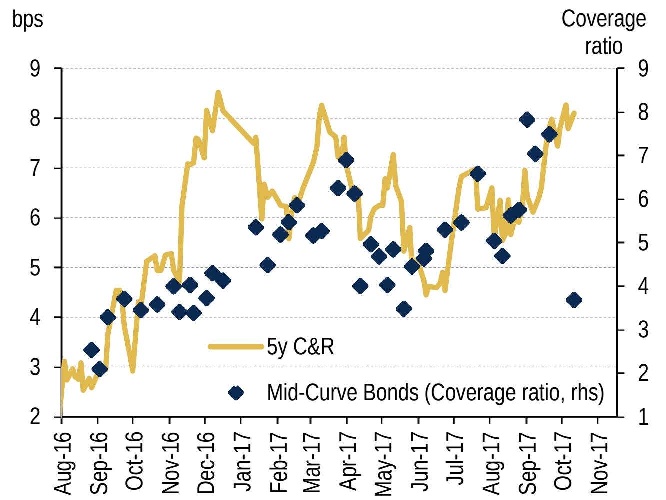
Chart 9: BEIs valuations are more consistent with tightening cycles

Spread of inflation expectations (5y BEI) vs. actual CPI outcomes



Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 10: Tender results for mid-curve government bonds and C&R



Source: Merrill Lynch Global Research, Bloomberg

In our view, the second-round effects from rising utilities as businesses pass on higher costs supports a stronger underlying pulse in the coming quarters. As such, we see core inflation picking-up to 2.1% in 2018 from 1.8% in 2017, with core inflation returning to the RBA's 2-3% target band in 1H2018.

The CPI basket is due for its regular six-yearly reweighting next quarter, which will follow previous methodology using the Household Expenditure Survey (also conducted every six years). We receive the new CPI weights, applying to Q4 CPI and for the subsequent three quarters on 6th November. Our analysis, based on estimates of these weights, suggest that the upwards bias currently in the CPI from infrequent reweighting is likely to be diminishing due to rising utilities inflation (See: Power surges reinforce the inflationary pulse).

Focus shifts to the upcoming index extension

We expect large index extensions following the heavy round of supply in October from the Commonwealth, state borrowing authorities and SSAs The gross supply has already exceeded AUD 10bn in October and includes AUD 8.3bn in newly established maturity lines and a AUD 2.1bn tap of ACGB 2047.

Front end – UK

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- We continue to like Dec17-Dec18 OIS flatteners going into next week's expected hike. We see a dovish press conference and vote trumping hawkish QIR forecasts.

See 'UK Watch: the one and only?' for full BoE preview

Flattener at risk of a hawkish BoE hike

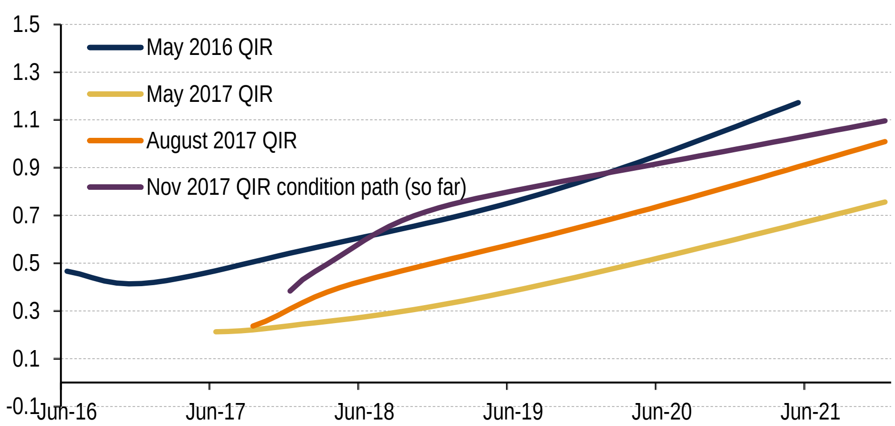
We recommended a Dec17-Dec18 MPC dated OIS flattener on September 22nd (entered at 33.5bp, currently 33.8bp, targeting 12bp with a stop at 39bp). In our view that the BoE will hike rates by 25bp at next week's meeting but go no further, we believe the two-and-a-bit hikes priced by the end of next year as overdone.

While we still think Dec17-Dec18 MPC-dated OIS flatteners will ultimately be the right trade, it is at risk of a hawkish spin from the BoE on our forecasted 25bp hike next week. However we see a dovish press conference and voting pattern trumping hawkish inflation forecasts in the QIR.

Above target inflation forecasts a risk

From a broader perspective than our micro-curve steepener, the market seems to agree with us that the BoE is unlikely to get far off the ground with hikes (Chart 11). This could prove problematic for the BoE given that if they reduce their inflation forecasts close to target at the 3 year horizon they are validating a curve that sees them hiking less than three times by the end of 2019. While the BoE have always maintained that hikes would be gradual once they begun, this may be too gradual a pace for them to be comfortable with.

Chart 11: BoE forecasts not likely to be consistent with market path



Path of rate hikes implied by OIS. Source: BofA Merrill Lynch Global Research

Expect 6-3 vote but scope for a 5-4

As we detail in the report linked above, we expect a November rate hike to be voted in favour of by 6 of the 9 MPC members. New members David Ramsden and Silvana Tenreyro comments at their Treasury Select Committee hearings last week did not suggest they supported a hike, while deputy governor Cunliffe suggested he was also not in favour when he said the timing of a hike was 'an open question'. We also note that we have not heard from Ben Broadbent or Andy Haldane recently, leaving open potential for a 5-4 vote.

Asymmetry of monetary policy at the ZLB supports a dovish hike

The BoE have already expressed caution in their language around a hike, with both written and verbal communication from various members referring to the MPC's ability to reverse the decision were it to turn out to be a mistake. But with no room left to cut rates materially a mistake could turn out to be costly for the BoE.

This would be the first time the BoE is hiking rates in more than 10 years and they do so in the face of a Brexit-shaped cloud of uncertainty hanging over the economy. We find it hard to envision next week's press conference being used not only to deliver a hike, but also a message to the market that causes considerable further tightening in financial conditions beyond the 25bp move itself.

Volatility

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- Historical analysis suggests a predictable central bank, like the Fed in 2014 and the ECB this week is supportive of short vol strategies in particular in the 10y and 2y.
- In the US, updated analysis of our systematic short vol strategies continues to show 2y tail outperforms in hiking cycle; 5y vol is vulnerable in a change of Fed chair.

This is a summary of the piece published in US Rates Viewpoint on 10/20

Selling low works in vol

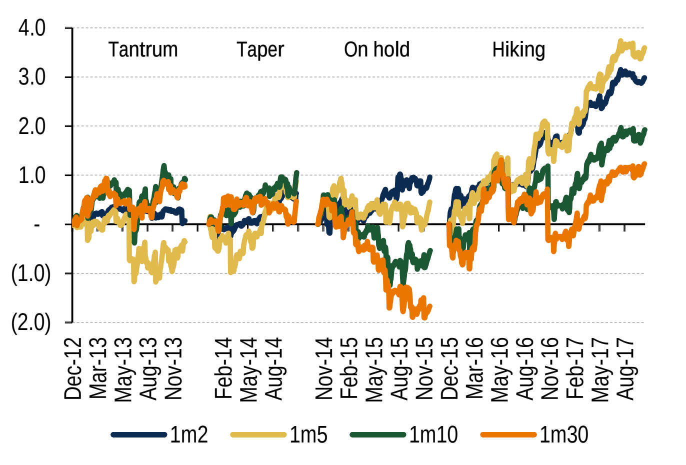
3m10y EUR swaption vol reached a record low this week. Still, a look at the 1 month trading range for 10y swaps tells you short vol strategies are still the game in town.

In August, we had an initial look at these strategies in US rates and their sensitivity to hedging parameters across tails. We focused on the last 3 years (through tapering, a Fed on-hold, and the start of the hiking cycle). We now expand the analysis to: (1) Include 2013, which saw the US taper tantrum unfold, and (2) EUR rates, from the start of ECB QE in Mar-15. Additionally, we now account for costs (bid/offers for options, and delta hedges) and consider the results with different delta thresholds for hedging.

Short tails continue to perform

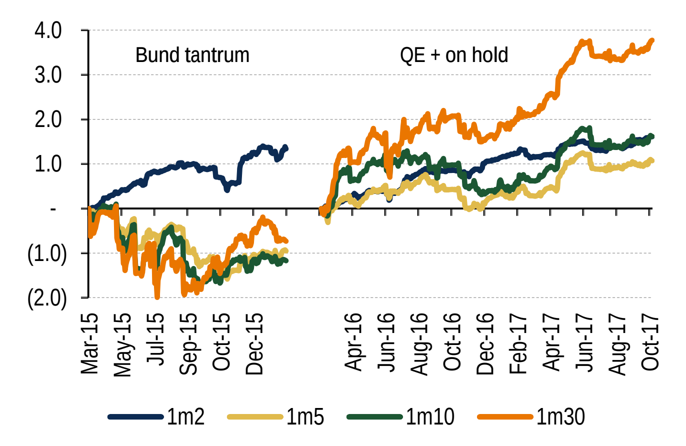
The short vol position in the 2y still would have outperformed those in other tails during the hiking cycle, even after accounting for the higher cost incurred on 1m2y straddles relative to longer tails (in $ bid/offer paid for the same amount of PV01 risk). In addition, the results of the fully hedged positions in short tails would have been better han those with high delta thresholds, despite the higher delta hedging costs (Table 5).

Chart 12: Cumulative short 1m straddle performance in the US for different tails. Rebased on diff phases of Fed policy - daily hedged ($mm)



We note that back-testing is hypothetical in nature and reflects application of the strategy prior to its introduction. It is not actual performance and it is not intended to be indicative of future performance. Source: BofA Merrill Lynch Global Research.

Chart 13: Cumulative short 1m straddle performance in EUR since start of QE, rebased at last rate cut in Mar16 – daily delta hedge (€mm)



We note that back-testing is hypothetical in nature and reflects application of the strategy prior to its introduction. It is not actual performance and it is not intended to be indicative of future performance. Source: BofA Merrill Lynch Global Research

EUR: Lessons from the US, ahead of the ECB's QE exit

An analysis of the results in the US, in combination with those obtained in EUR since the start of QE provides us with key takeaways for the choice of short EUR rates vol strategies heading into the ECB's QE exit in 2018. Specifically, it highlights that ECB communication will be a key factor to determine the optimal sector for a systematic short vol position.

This week's ECB decision, that came very much inline with consensus expectations (a €30bn/m extension for 9 months), left the rates forward guidance unchanged, and maintained the open-ended nature of QE, does certainly paint the ECB as central bank that strives for predictability. As such, it points to a continuation of the Mar16-Oct17 trading environment, which resembled the 2014 environment in the US. In turn, this suggests that short vol positions in 2y and 10y tails would appear as best risk-reward.

US: at a juncture of a changing Fed

While shorting vol in the 5y tail would have done well in the last two years, the tide may be turning soon, as a new Fed chair is about to be nominated. This is mainly based on our view that changes in the Fed communication in 2013 were likely responsible for the weak performances in systematic short vol positions, especially in the 5y tail. That is not all however. In fact, at this stage, we find that the 5y point may be prone to a sharp correction higher, trading rich relative to the Fed hikes priced in the very front-end.

Table 5: Typical short volatility strategies variations

Monthly returns are expressed in $ K, for €100mln 10y equivalent notional; risk adjusted returns are calculated as annualized monthly returns divided by standard deviation per annum

	1m2y straddle				1m5y straddle				1m10y straddle				1m30y straddle			
Delta hedge	Daily	20K threshold	50K threshold	None	Daily	20K threshold	50K threshold	None	Daily	20K threshold	50K threshold	None	Daily	20K threshold	50K threshold	None
US																
Tantrums (Dec '12-Dec '13)																
Avg monthly return (K $)	5	(3)	(43)	(30)	(30)	(96)	(174)	(220)	67	65	(117)	(137)	58	47	98	(20)
Annualized return (%, *)	0.1%	0.0%	-0.5%	-0.4%	-0.4%	-1.1%	-2.1%	-2.6%	0.8%	0.8%	-1.4%	-1.6%	0.7%	0.6%	1.2%	-0.2%
Risk adj. return	0.12	(0.07)	(0.50)	(0.30)	(0.36)	(0.85)	(1.21)	(0.61)	0.97	0.69	(0.79)	(0.32)	0.96	0.58	0.58	(0.06)
Taper (Jan '14 - Oct '14)																
Avg monthly return (K $)	49	58	102	38	49	131	147	73	65	63	174	11	5	(52)	165	(54)
Annualized return (%, *)	0.6%	0.7%	1.2%	0.5%	0.6%	1.6%	1.8%	0.9%	0.8%	0.8%	2.1%	0.1%	0.1%	-0.6%	2.0%	-0.6%
Risk adj. return	0.97	0.94	1.33	0.25	0.44	1.48	0.95	0.27	1.44	1.12	1.68	0.05	0.09	(1.10)	1.33	(0.26)
On hold (Nov '14-Nov '15)																
Avg monthly return (K $)	66	70	151	119	23	87	152	237	(44)	(16)	154	168	(125)	(169)	(151)	10
Annualized return (%, *)	0.8%	0.8%	1.8%	1.4%	0.3%	1.0%	1.8%	2.8%	-0.5%	-0.2%	1.8%	2.0%	-1.5%	-2.0%	-1.8%	0.1%
Risk adj. return	0.98	0.97	1.58	0.73	0.24	1.04	1.39	0.80	(0.33)	(0.09)	0.93	0.52	(1.03)	(1.29)	(0.83)	0.03
Hiking (Dec'15-Oct'17)																
Avg monthly return (K $)	155	162	153	213	154	77	107	268	48	19	155	275	8	39	78	280
Annualized return (%, *)	1.9%	1.9%	1.8%	2.6%	1.8%	0.9%	1.3%	3.2%	0.6%	0.2%	1.9%	3.3%	0.1%	0.5%	0.9%	3.4%
Risk adj. return	1.83	1.82	1.10	1.00	1.76	0.72	0.58	0.83	0.41	0.12	0.81	0.84	0.06	0.23	0.38	0.90
EUR																
QE but Bund tantrum, ECB cutting rates (Mar '15 - Feb'16)																
Avg monthly return (K €)	111	101	83	(9)	(79)	(119)	(105)	(259)	(98)	(100)	(55)	(236)	(61)	(42)	30	(115)
Annualized return (%, *)	1.3%	1.2%	1.0%	-0.1%	-1.0%	-1.4%	-1.3%	-3.1%	-1.2%	-1.2%	-0.7%	-2.8%	-0.7%	-0.5%	0.4%	-1.4%
Risk adj. return	1.70	1.53	1.08	(0.08)	(0.94)	(1.47)	(1.06)	(1.39)	(0.80)	(0.86)	(0.31)	(0.78)	(0.46)	(0.25)	0.11	(0.28)
QE expanded and rates on hold (Mar '16 - Oct'17)																
Avg monthly return (K €)	81	91	87	90	53	75	112	101	80	107	250	219	189	214	270	321
Annualized return (%, *)	1.0%	1.1%	1.0%	1.1%	0.6%	0.9%	1.3%	1.2%	1.0%	1.3%	3.0%	2.6%	2.3%	2.6%	3.2%	3.9%
Risk adj. return	2.10	2.32	1.82	1.33	0.83	1.27	1.23	0.70	1.00	1.15	2.35	1.27	1.62	1.69	2.21	1.22

Note: The table reports performance on short 1m straddle trade in 2-, 5-, 10-, and 30y tails. We assumed the sale of 1m straddles struck at ATMF on a monthly basis and held until expiration before entering a new trade. Option costs are assumed to be: in US: 0.5ct, 1ct, 1ct and 3ct for 2y, 5y, 10y and 30y resp. and in EUR: 0.75ct, 1ct, 2ct and 7cts for 2y, 5y, 10y and 30y resp. Delta hedging costs are assumed to be 0.1bp for swaps bid/offer across tails in US and EUR. (*) in % of €100mln 10y equivalent notional. The average monthly returns are expressed in K$, based on $100mln 10y equiv. notionals ($450mln in 1m2y for USD and €500mln in 1m2y for EUR, 200mln in 1m5y, 100mln in 1m10y & 40mln in 1m30y). Source: BofA Merrill Lynch Global Research.

We note that back-testing is hypothetical in nature and reflects application of the strategy prior to its introduction. It is not actual performance and it is not intended to be indicative of future performance..

Supply – US

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- We expect Treasury to keep coupon sizes steady at the Nov refunding as they wait for greater clarity on fiscal developments.
- Treasury will likely boost nominal auction sizes starting at the Feb refunding in a gradual manner across the curve. Bill supply will increase over the coming fiscal year and meet the initial funding need from the Fed portfolio run off.

Originally published as a US Rates Supply Preview on Oct 26, 2017

Treasury supply to increase after greater fiscal clarity

We have revised our Treasury borrowing estimates and now believe that Treasury will refrain from announcing any increase to coupons at the November refunding. Treasury will almost certainly need to boost their auction sizes in coming quarters in order to account for the Fed portfolio runoff and increased deficits. However, we expect Treasury to refrain from increasing coupon auction sizes at the current refunding so that they can (1) allow for more time to gain clarity on fiscal developments, including tax reform & debt limit (2) better articulate a strategy for coupon size increases to the market.

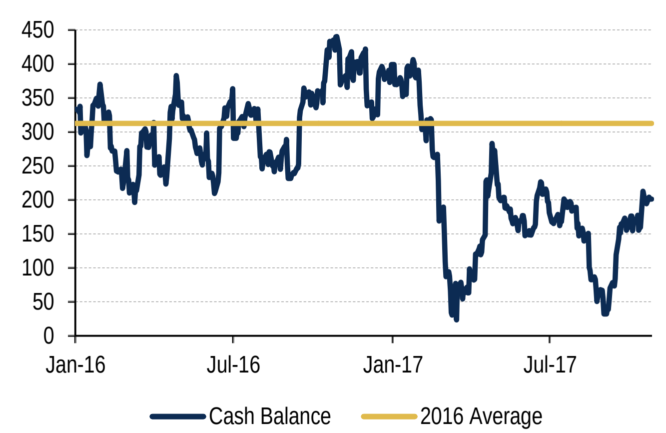
Our updated financing estimates see Treasury needing to raise between $423 and $545 bn in net new supply over the next two fiscal years (Table 6). For FY '18 our economists estimate a deficit of $645 bn, which does not include any explicit expectations for fiscal stimulus. We expect Treasury will also need to fund a $100 bn cash balance boost from current levels and $90 bn in other funding needs over the next fiscal year (mostly direct student loan activity) (Chart 14). These funding needs along with the Fed's portfolio run off will necessitate higher coupon and bill auction sizes in coming years.

Table 6: Treasury financing estimates, fiscal year ($bn)

	Item	2018	2019
1	Deficit	645	690
2	Change in Cash Balance	100	0
3	Other funding need	90	90
4	Total borrowing need (1+2+3)	835	780
5	Amount raised w/ constant sizes	2,047	2,047
6	Amount maturing	1,831	1,935
7	Net raise (4-5)	216	112
8	Fed reinvestment	196	123
9	Fed rolloff	175	284
10	Net raise incl Fed (7+8)	412	235
11	Net financing surplus (need) (10-4)	-423	-545
12	Increase in coupon funding	164	408
13	Increase in bill supply ((12+11)*-1)	259	137

Source: BofA Merrill Lynch Global Research, US Treasury, FRBNY

Chart 14: Treasury cash balance is low vs 2016 levels ($bn)



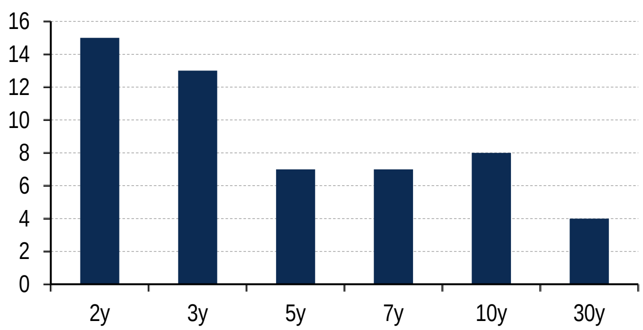
Source: BofA Merrill Lynch Global Research, Bloomberg

Coupon increases across curve, concentrated at front end

We now expect that Treasury will likely boost auction sizes across the curve starting at the February refunding and meet their interim funding need with bills. This is consistent with Treasury's prior guidance which stated it would respond to the borrowing needs from the Fed "by increasing both Treasury bill and Treasury nominal coupon auction sizes, beginning with bills and then coupons." The specific reference to "nominals" makes it unlikely they will boost TIPS or FRNs in the near term. If there is no fiscal clarity by February, it is possible that Treasury delays coupon increases to May.

When Treasury increases its coupon sizes we expect this will be done gradually across the curve with the largest increase in coupons concentrated at the front end. To gauge how nominal offerings would be increased at each tenor, we consider the extent of "capacity" that is implied by the maximum auction sizes through the primary dealer survey (Chart 15). Given that Treasury has the greatest "capacity" at the front end, we have penciled in a gradual increase in new issue auction sizes of $9 bn for 2 & 3Y, $6 bn for 5Y & 7Y, and $2 bn for 10Y & 30Y (Exhibit 1, Chart 17). Such a coupon distribution would generally hold Treasury's WAM steady through FY '19, but Treasury could consider more long-dated issuance to further extend WAM.

Chart 15: Treasury "capacity" to boost auction sizes ($bn)



Source: BofA Merrill Lynch Global Research, US Treasury

Exhibit 1: Current expectations for Tsy auction sizes in FY 2018 ($bn)

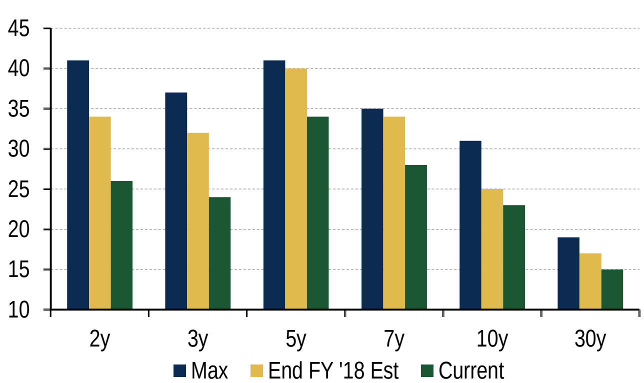
	2Y	3Y	5Y	7Y	10Y	30Y	5Y II	10Y II	30Y II	2Y FRN	Gross	Mature	Net
Oct-17	26	24	34	28	20	12	0	0	5	15	164	156	8
Nov-17	26	24	34	28	23	15	0	11	0	13	174	132	42
Dec-17	26	24	34	28	20	12	14	0	0	13	171	104	67
Jan-18	26	24	34	28	20	12	0	13	0	15	172	156	16
Feb-18	27	25	35	29	24	16	0	0	7	13	176	126	50
Mar-18	28	26	36	30	21	13	0	11	0	13	178	102	76
Apr-18	29	27	37	31	21	13	16	0	0	15	189	204	-15
May-18	30	28	38	32	25	17	0	11	0	13	194	127	67
Jun-18	31	29	39	33	22	14	0	0	5	13	186	107	79
Jul-18	32	30	40	34	22	14	0	13	0	15	200	170	30
Aug-18	33	31	40	34	25	17	14	0	0	13	207	134	73
Sep-18	34	32	40	34	22	14	0	11	0	13	200	116	84

Source: BofA Merrill Lynch Global Research, US Treasury

Our revised borrowing projections also require a larger increase in bill supply. This would be consistent with prior guidance from Treasury that they would like to grow bills as a percentage of their portfolio and the fact that bills consistently trade rich to OIS (Chart 18). Treasury has adequate bill capacity according to the PD survey to meet our projected FY '18 needs but might consider a 2M bill towards the end of this fiscal year in order to satisfy future bill supply increases. It is also possible that Treasury might consider larger or more rapid coupon supply increases to lessen the degree of bill funding need.

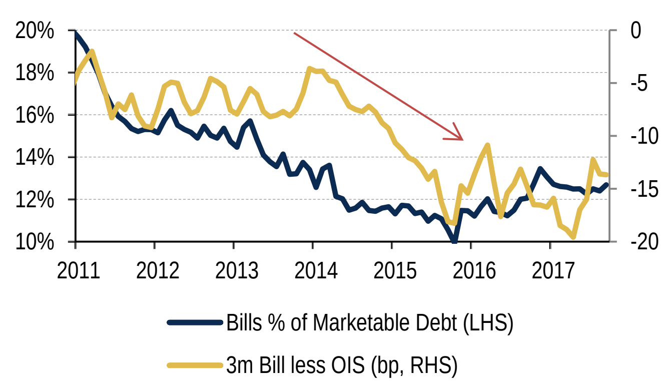
As discussed here, we expect no announcement of ultra-longs in the near term. We expect the Treasury Borrowing Advisory Committee to discuss merits of further WAM extension at this refunding and believe they will continue to reiterate a preference for intermediate vs longer-dated issuance.

Chart 16: Treasury auction sizes vs PD max amounts ($bn)



Source: BofA Merrill Lynch Global Research, US Treasury

Chart 17: Bills richened as their relative share of debt declined



Source: BofA Merrill Lynch Global Research, Bloomberg

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US 10y breaks 2.4%, bunds lag as spread widens

- US 10y yield finally broke up through 2.40%, which was a technical line in the sand holding back many of this year's bond market sell offs. To add further confirmation that 2.40% is broken, we'd also like to see this Friday's close be above 2.40%. All together this makes us technically think it will be appropriate to sell rallies at yield support, such as the rising trend line and 200d SMA in the lower/mid 2.30's.

- While US 10y broke through 2.40%, GER 10y Bund yield failed to close above trend channel resistance leading to a wider US – GER 10y yield spread. This spread's double bottom is confirmed and now above 200 bps. This is a significant level because it was the old neckline of a head and shoulders top. We think the highs of the right shoulder (220 bps) could be tested this year. (Chart 2)

Chart 18: US 10y yield – Daily chart

Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 19: US – GER 10y yield spread

Source: BofA Merrill Lynch Global Research, Bloomberg

Special Topic

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This in an excerpt from Global Rates Viewpoint, 25 October 2017

Majority want LIBOR to stay but see phase out as likely

- 80% of our 164 survey respondents believe that LIBOR should continue with a more robust methodology, and 73% believe LIBOR should continue alongside a risk-free reference rate alternative.
- However, only 40% of respondents expect LIBOR *will* survive and 60% say it will eventually be phased out.

Shift away from LIBOR expected to increase costs

- 67% of banks expect hedging costs to increase with LIBOR's phase out, with costs likely passed on to customers.
- Asset managers were more mixed with 56% thinking hedging costs would not increase with LIBOR transition.

Transition timing depends on liquidity of alternative

- A large majority see development of a risk-free alternative rate as necessary.
- But the majority expects liquidity in alternative reference rates to be insufficient by 2021. As a result, a large majority of respondents say a 2021 LIBOR phase out has a probability of 50% or less.
- Participants expect to decrease swaps usage, and shift activity into OIS, with banks having the strongest conviction in this view.
- Most said they would wait for more information and improved liquidity before changing hedging or trading preferences.

Fallback to OIS+spread likely, but problematic

- The fallback to OIS+spread is seen as most likely if LIBOR ceases.
- While respondents consider such a fallback problematic, 62% of banks expect to maintain their existing LIBOR positions and use the fallback. 53% of asset managers expect to unwind legacy positions if LIBOR ceases.

Market impact = L-OIS widening & steepening

- The vast majority of respondents believe that LIBOR's phase out will result in longer-dated LIBOR-OIS widening and a steepening of the LIBOR-OIS curve.

More conviction of LIBOR transition in GBP

- While the GBP sample size was only 16 respondents, a significantly higher proportion (87%) of GBP swap users expect LIBOR to be phased out, with most expecting it to be replaced with a risk-free alternative.
- A majority of GBP respondents see liquidity as a problem for transition out of LIBOR by 2022.

Rates Alpha trade recommendations

Table 7: Global Rates Trade Book - open trades

	Open trades	Entry date	Entry level	Target	Stop	Latest level	Trade rationale/Time horizon	Risk
Europe	3m 10s30s bear steepener	06-Oct-17	0k	400k	-200k	36k	Steepening on structural long-end paying / 3m	LDI receiving in long-end.
	Short OATei breakeven	21-Sep-17	192	165	208	197	B/E curve too steep and convexity attractive / 3m	Heavy 50y supply
	BTPei 2023-2026 real yield flattener	13-Sep-17	67	50	75	69	5y real rates too high. Italian index month end supportive / 3m	Heavy supply of the 2026 issue
	Long SPGBei 24 breakeven vs. 7y infl swap	16-Aug-17	34.1	15	45	23	Iota wide relative to ASW levels / 6M	Heavy SPGBei issuance
	Pay USD 5y5y vs EUR 5y5y	07-Aug-17	100	140	85	115	Macro and technical factors pushing for US-EU divergence	Further reduction in 10y equivalent purchases by the Bundesbank
	2y5y payer ladder ATM/ATM+25/ATM+50	28-Jul-17	-200k	200k	-400k	-121k	Positive carry trade, consistent with view that EUR rates are unlikely to selloff dramatically	A sharp selloff with rising vol and richening payer skew
	5y swap spread widener	02-Aug-17	49.0	60.0	43.0	52.9	Positive carry risk-off hedge / 6m	A sustained sell-off in Bunds, with risk assets outperforming
	Long US-EZ 10y10y inflation spread	27-Jun-17	18.0	60.0	-5.0	23	Relative inflation pressures, roll-down / 6m	Upcoming EURi index events
	Short the belly of the 5s-10s-30s BTP fly	16-Jun-17	-35	-10	-50	-37	Carry efficient exposure to supportive long-end BTP supply/demand	Underperformance of wings / decrease in BTP yields.
	Short belly of OATei 2022-24-27 barbell	12-Jun-17	16.1	8.0	20.0	13	Cheap RV and favourable index extension /1m	Concentration of supply in the 10y
	Pay Jan18 ECB	26-May-17	-33.2	-21.5	-36.5	-35.6	Attractive risk-reward as market is underpricing the probability of a technical hike over next year	A more dovish than expected ECB is the main risk
	SPGBei 2019-21-24 barbell	12-May-17	53.5	33	65	43	RV cheapening of 2024 after 10y sale	More 2024 switches into new 10y
	DBRi 2020/2030 real curve flattener	13-Mar-17	85.1	50.1	105.1	95	April reinvestment and rebalancing flows/6m	Richening of short-dated Germany
	Buy 50y BTPs vs 30y BTPS	16-Nov-16	30	-8	55	23	50y is not eligible for QE, and term premia in the 2-31y sector would increase if QE was to end/6m	Risk is ECB QE continues and peripheral risk premium stays low.
	5y fwd 2s10s inflation flattener	07-Sep-16	38	18	48	34	Forward inflation curve too steep in swaps/6m	Sharp appreciation in the EUR
	Pay 5y5y EUR 3s6s basis	10-Aug-16	11.3	13.3	10.3	11.3	Sizable corp issuance to support wider basis /6m.	corporate issuance underwhelms
UK	10s50s real yield curve flattener	12-Oct-17	17.2	0	25	15.5	Upcoming BoE reinvestments and Nov extensions	Continued upside surprises to RPI
	Dec17 – Dec18 MPC-dated OIS flattener	22-Sep-17	33.5	12	39	34.2	Too many hikes priced into the front end / 3m	BoE hikes more than once
	Short UKT 2.27% '24 vs. UKT 0.75% '23	21-Jul-17	1.1	7	-3	2.4	RV opportunity / 3m	24s sees strong demand in the BoE
	2y1y vs 10y10y basis steepener	13-Jun-17	-8.5	12	-19	-0.5	Benchmark migration flows supportive /6m	No change of benchmark to Sonia
	Short UKT 3.75% 2020 vs. OIS	24-Mar-17	-26.4	0	-40	-22.4	Carry positive Brexit hedge/ 6m	Short-dated cash richens further
	Long UKT 2068 v short 10y20y swap	08-Dec-16	16.1	-30	40	-6.1	Demand & supply dynamics show continued demand for ultra-long end cash/6m	Long swaps continue to outperform
	GBP 2s10s 2y fwd inflation steepener	12-Aug-16	3	23	-10	-2	Currency pass-through to inflation subsides /6m	Sharp further fall in £
	UKTI 2050/55 flattener	12-Aug-16	1.3	-4	3.5	-1	Acquire cheap convexity/3m	Weak uptake of super-long supply
	Long RPI 3y 3.5% ZC inflation cap	21-Oct-15	26	-	-	7	£ weakness to lift inflation post-Brexit /6m	£ strength, severe recession
US	Sell 2y cash Treasuries vs. OIS	27-Sep-17	-3.5	5	-8	-3	Reversal in reserve manager demand and higher auction sizes should help cash underperform OIS	Foreign selling does not materialize and tax reform disappoints
	6m 2s5s conditional bull steepener	21-Sep-17	0k	+400k	-200k	+2k	Post Sept FOMC, 2s5s now has room to bull steepen if rates were to decline.	Disappointment in tax reform
	Long 5y breakeven	02-Aug-17	1.68%	2%	1.5%	1.78%	Moves higher in rates would be led by breakevens as the Fed is less inclined to hike rates soon.	Significant risk assets correction.
	5s30s Libor/Funds basis flattener	27-Jul-17	10	0	15	11	Moving to fixed spread Libor option would imply a flat term structure of the Libor/Funds basis curve	Warly migration of the receive libor flow in the long end to receive OIS.
	2y 3s7s bear steepener	20-Jul-17	-5k	250k	-125k	-80k	A shift higher in terminal rate as peak pessimism fades should steepen the curve / 6m	Significant shock lower to terminal rate or slowdown of hikes
	6m5y payer ladder	12-Jul-17	-100k	700k	-100k	+120k	We see a transition from a CTA-led move to a slow drag higher in yields / 6m	A continued sharp rise in rates in the near term
	Long 3y 5s30s bear steepener & 1y2y payer	25-Apr-17	0	2mn	-900k	+300k	Steepeners + front end shorts for deficit expansion	Significant bear flattening
	Sell 2s-3s-5s swap butterfly	01-Mar-17	-6	5	-12	-4	3y point is most vulnerable in a bearish move /6m	Dramatic slowdown in tax reform
	Buy 30y treasuries vs matched Libor swap	16-Nov-16	-56	0	-75	-29	De-regulation may contribute driving swapsreads back to pre-crisis levels /12m	The main risk is that policy changes retain strict capital requirements
	Long US$100mn 2y1y payer, 2.50%	16-Nov-16	17	48	0	5.5	We see room for the belly of the curve to reprice to the dots. Vol in 2y1y could also richen /6m	Reversal of the recent selloff on disappointment re fiscal easing
Asiapac	TCV Nov-26 vs. WATC Jul-25	17-Oct-17	10	25	2	9	Relative supply dynamics between the two states/6m	Earlier than expected boost to GST revenues/6m
	NZ 1y vs. 5y swap steepener	19-Oct-17	68	95	58	66	Inflation profile and RBNZ policy response/6m	Shift to a tightening bias from the RBNZ/6m
	QTC Jun-21 vs. ACGB Nov-27	29-Sep-17	43	60	30	48	RBA on hold and ACGB supply on longer-end/3m	Policy outlook change or risk-off event impacting credit spreads/3m
	AUD OIS 5m vs. 12m steepener	11-Jul-17	6	25	2	6	Steady RBA this year and tighter policy expectations next year/6m	Earlier than expected shift in policy guidance this year/6m

Source: BofA Merrill Lynch Global Research. Bid/offer spreads are not accounted for in initiation and closing levels. Does not reflect tax withholdings or any investment advisory fees. Past performance is no guarantee of future results. A complete performance record is available on request. Trade initiation and termination prices are determined at the time we publish the initiation and termination of the trade. Prices used to mark current levels of open trades in our model portfolio are taken at the time the day prior to the publication of the Global Rates and FX Weekly. Trade levels are expressed in basis points when not specified in the table

Table 8: Global Rates Trade Book - closed trades

	Closed trades	Entry date	Entry level	Target	Stop	Close date	Level closed
Eurozone	Long 10y France vs Spain	09-Feb-17	63	120	30	05-Oct-17	81
	Rec 3m Dec18, pay 12m Jun20 (Eonia)	25-Aug-17	39	50	33	25-Sep-17	44
	Dec18-Jun20 steepener	25-Aug-17	32	42	27	25-Sep-17	39
	1y1y vs 10y10y basis steepener	13-Jun-17	-7	1	-10.5	12-Sep-17	-1.9
	Long 3m2y ATM payer	12-May-17	87K	180K	0	10-Aug-17	Expired
	Long Mar19 Euribors	19-Jul-17	100.035	100.135	99.985	08-Aug-17	100.105
	10y German ASW widener	29-Jun-17	42	56	35	02-Aug-17	47
	Long Sep18 BKO vs Jul18 DBR	05-Jul-17	3	-2	6	17-Jul-17	-2
	4m10y 50-wide strangle	16-Mar-17	500K	1.5mln	0	14-Jul-17	Expired
	Long 3m30y vol vs 3m10y (values in ratios)	06-Apr-17	1.14	1.25	1.09	06-Jul-17	Expired
	Receive 4s on the 2s4s7s PCA-weighted fly	16-Mar-17	-12.9	-14.3	-12.1	05-Jul-17	-15.1
	Sell 10y20y EUR inflation	05-Jan-17	217	170	240	28-Jun-17	202
	Long 5y Dutch CDS	09-Feb-17	25	50	15	01-Jun-17	21
	Pay Sep17 Eonia	12-May-17	-35.2	-31.5	-37	25-May-17	-35
	Short Dec18 Euribor	07-Apr-17	100.13	100.01	100.19	25-May-17	100.11
	6m10y payer spread & receiver	09-Feb-17	670K	1200K	350K	11-May-17	350K
	Long 5y Germany against 1y1y swaps	16-Mar-17	23	43	13	25-Apr-17	19
	Long 10y BTP future vs short 2y BTP future, delta neutral	16-Mar-17	200	100	250	25-Apr-17	181
	Long OATei 47 B/E vs 30y EUR inflation	10-Feb-17	25	-5	40	25-Apr-17	25
	Long 5y5y French inflation vs Euro inflation	10-Feb-17	11.8	30	0	25-Apr-17	17.3
	3m fwd 2s5s10s receiver fly (ATM)	12-Jan-17	0	200	-100	13-Apr-17	-75
	Receiving the 3m EUR basis	14-Feb-17	-27.5	-60	-10	04-Apr17	-16
	6m30y ATM+25/ATM+50 payer spread	19-Jan-17	1.25mn	2.25mn	750K	14-Mar-17	1.34mn
	Long the Apr21 PGB vs May21 BTP	10-Nov-16	132	86	155	02-Feb-17	125
	30y/50y BTP flattener	06-Oct-16	48	25	60	02-Feb-17	25
	Short 3m5y ATM+25 payer	08-Dec-16	-200K	0	-300K	18-Jan-17	-25K
	Long 3m7y EUR vs USD OTM receiver	13-Oct-16	0K	500K	-250K	13-Jan-17	0K
	Short OATei 2047 v OAT 2066	13-Oct-16	163	130	190	05-Jan-17	190
	Receive 2y1y Eonia vs 2y1y USD OIS	23-Nov-16	170	220	145	05-Jan-17	191
	Mar17 FRA-OIS widener	21-Sep-16	6.25	10	4	05-Jan-17	3.5
	Long ATM 5y10y payer in USD vs OTM 5y10y EUR payer	04-Dec-15	0K	-	-	16-Dec-16	2500K
	Sell German 2y vs OIS, buy 10y vs OIS	16-Nov-16	-17	14	-34	08-Dec-16	-28
	Short 1x2 1y2y EUR receiver spread	03-Dec-15	0	-	-	05-Dec-16	-200K
	Long 3m30y payer spread	10-Nov-16	900K	1700K	-500K	2-Dec-16	1700K
	OATEI 2022/24/27 short fly	18-Feb-16	10.3	5	15	1-Dec-16	10
	BTPei 2026/32/41 short fly	13-Apr-16	19.5	7	26	1-Dec-16	23.9
	Buy April 2020 BTP Italia	15-Jun-16	23.6	-0.4	34.6	1-Dec-16	34.6
	Long Apr21 PGB vs Apr21 OBL#173	21-Oct-16	233	190	255	10-Nov-16	229
	Long 3m10y EUR ATM payer vs one in close to ATM in USD	14-Oct-16	0K	800K	-400K	10-Nov-16	-400K
	Long 6m10y payer spread	23-Aug-16	3.5	-	-	10-Nov-16	11
	Long 6m30y payer ladders	20-Jul-16	3.3	-	-	10-Nov-16	8
	Germany 10s30s flattener	10-Mar-16	76.3	-	-	10-Nov-16	70
	Long BTP Sep19 vs OBL Oct19	26-Oct-16	73	63	78	31-Oct-16	78
	Short Schatz ASW	15-Jul-16	41	34	45	22-Sep-16	42
	Short Feb19 OBL #168 vs. matched maturity	15-Jul-16	-21	-14	-25	22-Sep-16	-25
	Long 1y4y EUR inflation	12-Jul-16	65	90	50	22-Sep-16	88.1
	Long OATi 2025 on ASW	16-May-16	10.8	-5	19	22-Sep-16	-0.5
	Buy Aug RXU6 call @ 167 and put @ 162	16-Jun-16	1.18	-	-	22-Jul-16	0
	OATei 2018/2027 flattener	11-Mar-16	78.5	40	100	12-Jul-16	55
	Ireland 5s10s flattener	28-Apr-16	95	75	105	28-Jun-16	75
	Long 5y Italy vs Spain	27-Apr-16	-0.6	11	-7	27-Jun-16	-5
	Buy Aug call on RXU6 @ 164	27-Apr-16	0.45	2.21	0	16-Jun-16	2.21
	Short 3y ASW	28-Jan-16	-32	-10	-42	10-Jun-16	-36
	Long German 10y on ASW	23-Jan-15	-31	-45	-24	08-Jun-16	-45
	6s30s breakeven flattener	18-Jan-16	96	70	110	06-Jun-16	70
	6m30y EUR payer spreads ATM/ATM+25bp	04-Dec-15	1200K	-	-	04-Jun-16	0k
	Long 2y inflation in EU vs US	23-Mar-15	80	20	115	16-May-16	115
	Long Spain 1y2y vs Germany	02-Mar-16	80	60	95	27-Apr-16	73
	5y5y US-EZ inflation swap widener	14-Oct-15	47	75	32	03-Mar-16	58
	Long TII 2040 vs short OATei 2040	26-Sep-15	4	40	-15	03-Mar-16	19
	Long Spain 1y2y	19-Feb-16	46	25	60	02-Mar-16	27
	Short 4y fwd 15y ASW	04-Dec-15	51	25	63	02-Mar-16	63
	Short 30y breakevens	16-Nov-15	338	315	350	02-Mar-16	315
	Long Italy 5y CDS basis	23-Nov-15	60	86	-	10-Feb-16	89
	Short EUR 5y5y inflation	04-Dec-15	1.76%	1.56%	1.86%	21-Jan-16	1.56%

UK	5s50s real yield curve flattener	12-Jul-17	80.3	45	98	12-Oct-17	62
	Pay fwd yield UKT5% 18 & UKT3.75% 20	06-Apr-17	20.8	45	8	14-Sep-17	43
	Long UKT 4.5% 2034	25-Aug-17	1.54	1.35	1.65	08-Sep-17	1.46
	Pay 10y5y GBP vs. EUR	09-Feb-17	-2	60	-30	08-Sep-17	-30
	Long UKT 5% 2025 v 2.25% 2023 on ASW	14-Dec-16	11	-1	17	14-Jul-17	5.6
	Short UKTI 2050 v UKT 2068	14-Feb-17	340	300	360	12-Jul-17	315.4
	Pay 5y UK real swap rate	07-Oct-16	-274	-235	-290	29-Jun-17	249
	Short UKT 4 2022 vs. OIS	02-Mar-17	-6	12	-15	23-Mar-17	-15
	Short breakevens UKT2024 vs UKTI2024	18-Nov-16	311	260	335	10-Mar-17	300
	Pay 2y3y real swap rate in UK vs. US	07-Sep-16	220	160	250	16-Feb-17	250
	UK 5s10s ASW flattener (I-Spread)	28-Oct-16	20	6	27	05-Dec-16	27
	UKTI 2019/22/27 short fly	12-Aug-16	21.5	8	28	1-Dec-16	10
	2022/2039 Gilt flattener	29-Sep-16	117.3	90	130	28-Oct-16	117.6
	Long UKT 4.25% 2039 on ASW	02-Sep-16	47.2	25	60	28-Oct-16	54.2
	Pay 2y3y real swap rate in UK	16-Sep-16	-243	-185	-275	06-Oct-16	-275
	Long UKTI 2019 breakeven	29-Jun-16	243.7	290	220	06-Oct-16	289
	Long UKT 2023 vs. 2025	21-Jul-16	12.8	20	8	02-Sep-16	16.7
	Long UKT 2046 vs 2045 & 2049	21-Jul-16	5.5	-5	8	02-Sep-16	3.8
	Buy LU6 99.75 call option, sell 99.125 put	27-Apr-16	1tick	-	-	18-Aug-16	1.5 ticks
	UKT 5s20s flattener	27-May-16	128	100	145	11-Aug-16	100
	Short UKT 2060 vs OAT 2060	29-Mar-16	-51	-100	-20	11-Aug-16	-3
	Receive July MPC OIS	22-Jun-16	42	-	-	14-Jul-16	46
	6m fwd 2s5s GBP swap steepener	09-Jun-16	22	40	15	27-Jun-16	15
	Short UK 10y10y inflation vs US	26-Sep-15	172	140	190	17-May-16	140
	Pay 10y fwd 20y UK real yield vs. US	26-Sep-15	238	175	270	17-May-16	196
US	Buy CAN 2y note vs US 2y note	19-Sep-17	16	0	24	16-Oct-17	-3
	Short 10y TIPS	16-Nov-16	35	100	0	02-Aug-17	48
	Pay 10y inflation swap	06-Sep-16	-28	40	-50	02-Aug-17	8
	Buy 98.625 puts on EDM7	01-Mar-17	4.5	15	0	01-Jun-17	0.3
	Receive May FOMC OIS at 87bp	01-Mar-17	87	81	91	3-May-17	90
	US 6m5y ATM/ATM-40bp receiver spread	10-Apr-17	640K	890K	490K	13-Apr-17	890K
	US 1y5y ATM+25bp payer	10-Apr-17	875K	1375K	625K	18-Apr-17	625K
	Pay Mar FOMC OIS at 71.5 and receive May FOMC OIS at 81	22-Feb-17	9.5	1	15	01-Mar-17	3.2
	2y Swap spread tightener	02-Feb-17	29.5	20	35	17-Feb-17	35
	Sell 6m 2s5s10s receiver fly	19-Aug-16	0K	600K	-350K	15-Feb-17	0
	Long US$100mn 3m5y payer, struck at 2.05%	16-Nov-16	7	22	0	15-Feb-17	2.9
	5s10s real yield curve steepener	07-Sep-16	22.8	70	10	02-Feb-17	60.4
	Long USCPI 1y 2% inflation cap	23-Feb-16	6	-	-	17-Jan-17	0
	Long payer 2y5y vs 3m5y	23-Sep-16	840K	1340K	640K	28-Dec-16	640K
	Buy RRB 2031	15-Jun-16	12.5	-20	30	16-Dec-16	30
	3m 5s30s bear flattener	20-Oct-16	0K	500K	-250K	15-Dec-16	871K
	Sell 2s-5s-10s swap fly (short 5y)	06-Sep-16	-8.5	10	-17	15-Dec-16	20
	3y fwd 2s10s swap flattener	18-May-16	51	25	65	15-Dec-16	23
Asiapac	Long ACGB 5y breakeven	13-Mar-17	171	195	155	25-Oct-17	168
	QTC Jun-21 vs. ACGB Apr-26	23-Jan-17	23	45	12	29-Sep-17	34
	Receive Feb18-OIS/3y/10y swaps butterfly	11-Jul-17	-12	-20	-6	18-Sep-17	-5
	NZ 1y vs. 5y swap steepener	30-Jan-17	92	130	72	18-May-17	72
	EuroDollar Mar18 vs. BAB Dec17 spread	24-Nov-16	44	15	24	10-Apr-17	15
	AU 2y2y vs. US 2y2y forward swap spread	24-Nov-16	36	10	60	05-Apr-17	18
	May-21 ACGB vs. paid 10y swap	19-Sep-16	51	80	35	10-Nov-16	80
	AU NZ 2y swap spread (s/q vs s/s)	02-Aug-16	36	20	46	4-Nov-16	44
	Long NSWTC IX 2020 breakeven	21-Jun-16	106	140	85	01-Sep-16	104
	KfW19s versus NSWTC19s	07-Dec-15	42	28	-	01-Sep-16	32
	AU NZ 2y swap spread (S/Q vs S/S basis)	24-May-16	48	20	62	08-Jul-16	49
	ACGB breakeven 2018	15-Mar-16	1.58%	2.20%	-	21-Jun-16	1%
	Jun 16 - Jun 17 BAB spread	07-Dec-15	6	20	-	09-Jun-16	-25
	Nov-2020 ACGB	21-Mar-16	2.13%	1.19%	2.25%	06-May-16	1.19%
	2Y1Y forward swap	21-Mar-16	2.23%	1.90%	2.35%	06-May-16	1.85%
	AU breakeven 2020 versus 2018	07-Dec-15	9	20	5	15-Mar-16	17
	AU Itraxx vs Asia Ex-Japan Itraxx	23-Nov-15	7	25	0	26-Feb-16	0
	Paid AU 5y5y versus Rec CA 5y5y	23-Nov-15	91	120	75	26-Feb-16	101
	AU 3y10y conditional steepener 6mth fwd atm+25 4:1 zero cost	24-Aug-15	86.75		-	24-Feb-16	0
	3y2y swap	07-Dec-15	2.97%	2.80%	-	08-Jan-16	2.72%
	QTC Feb-20	07-Dec-15	2.67%	2.50%	-	08-Jan-16	2.40%
	AU breakeven 2018	17-Aug-15	1.96%	2.30%	-	07-Dec-15	1.89%
	BAB Calendar Spread Mar6-Mar7	03-Jun-15	28	40	-	07-Dec-15	0
	AU NZ 2y swap spread	04-Nov-15	80	50	90	01-Dec-15	56

Note: Bid/offer spreads not accounted for in entry and closing levels. Does not reflect tax, withholdings or any investment advisory fees. Past performance is no guarantee of future results.
A complete performance record is available on request. Inception date – 31-Jul-14. For additional discussion on baseline views, valuation and risks to closed trades, please see links to the relevant reports.
Trade recommendations are highlighted green when the closing value is greater than the entry value and red when the closing value is less than or equal to the entry value. Source: BofA Merrill Lynch Global Research

Global rates forecasts

Table 9: Quarter-end bond yield forecasts

		Latest	*4Q17*	*1Q18*	*2Q18*	*3Q18*
USA	3m Libor	1.37	1.60	1.85	2.10	2.40
	2y T-Note	1.60	1.60	1.75	1.90	2.05
	5y T-Note	2.04	2.15	2.25	2.35	2.45
	10y T-Note	**2.42**	**2.85**	**2.85**	**2.85**	**2.85**
	30y T-Bond	2.93	3.15	3.25	3.25	3.25
	2y Swap	1.83	1.80	1.92	2.05	2.20
	5y Swap	2.13	2.20	2.28	2.38	2.45
	10y Swap	**2.42**	**2.85**	**2.88**	**2.90**	**2.90**
Germany	3m Euribor	-0.33	-0.33	-0.33	-0.32	-0.30
	2y BKO	-0.71	-0.59	-0.53	-0.47	-0.40
	5y OBL	-0.26	-0.20	-0.17	-0.10	0.00
	10y DBR	**0.47**	**0.55**	**0.60**	**0.65**	**0.70**
	30y DBR	1.32	1.35	1.40	1.45	1.50
	2y Swap	-0.18	-0.09	-0.04	0.01	0.05
	5y Swap	0.26	0.32	0.33	0.38	0.45
	10y Swap	**0.92**	**0.95**	**0.98**	**1.02**	**1.05**
Japan	3m Libor	-0.03	0.00	0.00	0.00	0.00
	2y JGB	-0.14	-0.12	-0.10	-0.10	-0.10
	5y JGB	-0.09	-0.05	-0.05	-0.05	-0.05
	10y JGB	**0.07**	**0.07**	**0.08**	**0.08**	**0.10**
	2y Swap	0.04	0.05	0.07	0.07	0.07
	5y Swap	0.11	0.10	0.10	0.10	0.10
	10y Swap	**0.26**	**0.29**	**0.30**	**0.30**	**0.32**
U.K.	3m Libor	0.40	0.60	0.60	0.60	0.60
	2y UKT	0.50	0.45	0.40	0.40	0.40
	5y UKT	0.84	0.90	1.00	1.15	1.25
	10y UKT	**1.40**	**1.50**	**1.60**	**1.80**	**2.00**
	30y UKT	1.95	1.90	2.00	2.10	2.20
	2y Swap	0.84	0.80	0.75	0.75	0.75
	5y Swap	1.12	1.10	1.15	1.30	1.40
	10y Swap	**1.42**	**1.55**	**1.65**	**1.80**	**1.95**
Australia	3m BBSW	1.69	1.90	2.00	2.10	2.20
	2y ACGB	1.86	2.00	2.10	2.20	2.30
	5y ACGB	2.24	2.50	2.60	2.60	2.65
	10y ACGB	**2.75**	**3.05**	**3.10**	**3.20**	**3.25**
	3y Swap	2.24	2.30	2.40	2.45	2.50
	10y Swap	**2.93**	**3.25**	**3.30**	**3.40**	**3.45**
Canada	2y Govt	1.47	1.65	1.75	1.85	1.95
	5y Govt	1.70	1.80	1.85	1.95	2.00
	10y Govt	**2.05**	**2.15**	**2.25**	**2.25**	**2.25**
	2y Swap	1.83	2.00	2.10	2.20	2.25
	5y Swap	2.08	2.16	2.21	2.31	2.36
	10y Swap	**2.34**	**2.41**	**2.51**	**2.51**	**2.51**

Source: BofA Merrill Lynch Global Research

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